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Seminar on the Role of Commercial Banks in the Clearing and Payments Arrangements

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THE ROLE OF COMMERCIAL BANKS IN CLEARING AND PAYMENTS ARRANGEMENTS IN THE EASTERN AND SOUTHERN AFRICAN COUNTRIES

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A. Introduction

At the fifth regular meeting of the Association of African Central Banks (AACB) in Lusaka (15-19 August 1977), the Economic Commission for Africa (ECA) presented a paper entitled "Institutional clearing and payments arrangements for the Eastern and Southern African countries" (E/CN.14/AMA/97). The following four alternative forms of institutional clearing and payments arrangements are outlined in that paper:

(a) Simple bilateral clearing and payments arrangements;

(b) Multilateral clearing and payments arrangements;

(c) A payments union;

(d) A monetary union.

After discussing each of the four alternatives, a caucus of central bank governors from the Eastern African subregion agreed to recommend the adoption of "simple bilateral clearing and payments arrangements" in the initial stage.

This paper will therefore discuss the role fo commercial banks within the context of simple bilateral payments arrangements. Firstly, however, a brief review will be made of the existing trade among the Eastern and Southern African (ESA) countries as a justification for the introduction of institutional payments arrangements.

B. Trade among ESA countries

Merchandise imports by ESA countries from each other have for several years now been between $US0.2 billion and $US0.3 billion (see Table 1a). It can be seen from the table that although intra-ESA imports have been slowly moving on an upward trend, their proportion to ESA over-all world imports (Table 1b) has been on a declining trend; it was 9 per cent in 1970 and went down to 5 per cent in 1977.

It is apparent that intra-ESA trade stagnated during the seven years covered in Table 1a. One of the main factors limiting trade among ESA countries (as is also true within Africa as a whole and other developing regions) is the homogeneity of a large proportion of their main exports as well as settlement problems. For instance, coffee is one of the major exports of seven ESA countries, tea, sugar and cotton are among the main exports of four ESA countries (see Table 2). Mineral exports, which are major exports of some ESA countries, are traded between ESA countries on a very small scale and only indirectly through goods manufactured in developed countries. Even the exportables which are not homogeneous are not traded among ESA countries on a large scale. This is so because of the very small size of the markets in these countries. Other factors limiting trade among these countries are the well known transport and communication bottle-necks as well as inadequate knowledge of each other's markets.

Many proposals have been made in various fora on how to mitigate the factors limiting intra-African trade. This paper does not intend to reiterate such proposals. However, one of the approaches which deserves a lot of emphasis is that any African country should, in its effort to diversify its range of exports, give more and more attention to the African market. This could be facilitated, among other things, by the introduction of bilateral payment arrangements. In this connexion therefore exporters should be encouraged to aim at markets of several African countries rather than concentrating only on a few. In short, intra-ESA trade has so far moved on an upward trend only slowly. However, its absolute magnitude justifies any effort aimed at introducing institutional payments arrangements.

C. The role of commercial banks

The subject of introducing reciprocal accounts between central banks in the Eastern African subregion of the AACB has been debated for some years now. Some central banks have already introduced such accounts; however, some of these accounts have so far been less active than would have been wished. Nevertheless this need not discourage efforts in introducing such accounts wherever it is appropriate and feasible to do so. Further, in most countries, trade and other related transactions are entrusted in the hands of commercial banks. It is therefore emphasized here that the commercial banks should also be encouraged to set up more nostro-vostro accounts between themselves than is the case at present. The promotion of such accounts would, however, not be a substitute for promotion of reciprocal accounts between central banks; the two would essentially be complementary. The procedure of making settlements between commercial banks would be as follows:

(i) Debits and credits

Instead of making settlements between themselves many times in a week commercial banks would debit and credit each other for a period of once every month at the end of which those in net debtor positions would pay. During this period before the settlement is made, the reciprocal accounts could be even in the respective local currencies. This would allow trade to take a much more fundamental course.

(ii) Mode of payment

Payment by net debtor commercial banks would be effected through central banks using, as it were, convertible currencies acceptable to the net creditor country.

(iii) Credit facilities

Such payments arrangements would require commercial banks to be willing to offer overdraft facilities to each other in order to accommodate those who find themselves in net debtor positions with the central bank guarantee. It is banks in a country with bilateral trade surpluses which would offer overdraft facilities to banks in trading partner with bilateral trade deficits.

(iv) Interest rates on credit facilities

Interest rates on overdrafts within the limits offered could be those normally charged on such a facility while pre-agreed penalty rates of interest could be charged if overdraft limits were exceeded or the life period of the facility unlawfully extended.

(a) Exchange risk

In order to minimize the risk arising from fluctuations in exchange rates, one alternative would be to keep the reciprocal accounts in terms of a stable unit of account, e.g. the SDR. However, this would be cumbersome in that it would involve converting the accounts which will originally be recorded in a domestic currency. A more plausible alternative would therefore be to pet currencies of trading partners to one stable unit of account, and in this case the SDR appears to be the most favourable.

Already, six of the ESA currencies covered in Table 3 are pegged to the SDR, while five are pegged to the US dollar, one to the French franc and two to other currency. It should be noted, however, that the exchange risk problem should not be given large weight; this is so because in the long run movements of currencies against each other would tend to offset each other and on balance minimize the risk born by either of any two trading partners.

(vi) Guarantees by central banks

Receipt of funds by net credit commercial banks from net debtor commercial banks could be guaranteed by central banks. This would be a safeguard cases of a net debtor country sometimes having inadequate convertible currencies.

(vii) Regular reports by commercial banks

Commercial banks would report (say monthly) gross debit and gross credit entries in their reciprocal accounts to enable central banks assess developments in these transactions.

Some of the advantages of the payments arrangements outlined above would be as follows:

(a) There would be less use of third party currencies but more of ESA currencies for purposes of promoting intra-ESA trade;

(b) The cost (cable and commissions) of transferring funds through banks in Europe relating to trade between ESA countries would be somewhat reduced. Also reduced may be the cost of delays in settlement. Such costs are of course passed by banks into their customers.

(c) The fluctuations in cost to the importer would ultimately be reduced to some extent since no third currencies would have to be used especially where the two are pegged to one denominator. For the same reason the exporter would be at somewhat advantageous position.

(viii) Educating importers and exporters

In the initial stages, importers and exporters may on their own not know clearly what they would benefit (as stated above) from increasing or starting trade with ESA countries. This would therefore be an area in which banks could be encouraged to educate importers and exporters as part of an effort to promote intra-regional and intra-continental trade.

Conclusion

The payments arrangements outlined above would raise less complications (particularly those of credit facilities and related aspects) if bilateral merchandise trade positions between most members of ESA countries were more or less in equilibrium. However, this position could be improved in the long run. Intra-ESA merchandise trade figures indicate that eight countries were in deficit while four were in surplus in most of the seven years through 1977. For such payments arrangements to be more effective one of the key prerequisites would therefore be a lot of good will from those ESA countries which are usually in surplus in the context of intra-ESA trade. It is assumed in the bilateral arrangements outlined above that exchange control regulations of trading partners would accommodate the problems which would arise.

TABLE 1a. MERCHANDISE TRADE AMONG THE EASTERN AND SOUTHERN AFRICAN COUNTRIES[1]

(Million of US$)

	COUNTRY	EXPORTS (f.o.b) 1970	1971	1972	1973	1974	1975	1976	1977	IMPORTS[2] (c.i.f.) 1970	1971	1972	1973	1974	1975	1976	1977
	Botswana	1.83	3.14	3.38	4.51	4.54	2.81	2.81	0.01	0.22	1.36	0.70	0.38	0.50	0.29	0.07	0.11
	Burundi	0.62	0.80	0.80	0.80	0.57	0.72	0.75	0.66	4.50	2.75	2.55	3.31	3.44	2.83	4.68	9.00
	Ethiopia	0.76	2.82	1.68	3.16	3.77	7.17	3.03	1.21	4.07	3.74	5.70	7.30	9.82	5.00	5.39	3.57
	Kenya	112.50	122.60	120.10	152.30	189.72	187.93	218.50	207.20	47.38	49.74	41.58	40.41	47.55	41.35	37.93	12.80
	Madagascar	1.93	1.47	1.11	1.59	4.92	1.97	1.82	0.35	0.58	0.83	1.19	2.65	4.01	1.61	2.60	3.62
	Malawi	1.74	6.42	7.65	9.54	8.71	8.34	4.77	4.57	4.14	6.08	5.32	7.79	10.07	8.06	6.82	3.73
	Mauritius	0.25	0.55	0.62	0.53	5.51	0.80	0.75	1.06	1.90	4.42	4.12	6.65	9.66	9.44	10.46	15.34
	Rwanda	3.30	3.20	2.40	1.51	2.10	0.23	1.56	2.22	5.10	4.95	6.09	7.13	11.83	18.22	20.15	18.37
	Somalia	0.73	0.66	0.20	0.20	0.54	0.45	0.58	0.85	4.62	5.77	6.48	7.91	15.31	13.11	8.63	9.11
	Swaziland	2.94	3.21	3.05	3.29	4.30	2.44	2.84	3.71	0.95	1.23	0.49	0.35	0.66	0.44	0.77	1.22
	Tanzania	31.34	40.09	27.58	32.99	45.72	35.17	42.81	20.10	47.96	46.68	49.69	51.54	69.57	61.48	83.23	34.99
	Uganda	36.96	26.62	24.30	15.55	11.94	6.33	3.76	2.75	53.47	60.27	48.95	66.53	81.31	81.88	80.50	134.26
	Zambia	6.51	9.60	7.30	11.56	24.90	9.33	9.54	15.20	27.49	39.64	33.31	44.95	56.28	38.72	35.31	30.45
(i)	Totals	201.41	221.18	200.17	237.53	307.24	263.69	293.52	259.89	202.38	227.63	206.98	246.98	326.16	282.43	296.42	273.57
(ii)	Trade with the whole world	2 394.63	2 097.11	2 407.66	3 153.38	4 032.27	3 529.13	4 164.80	4 878.85	2 131.36	2 610.62	2 644.49	2 930.14	4 427.71	4 782.74	4 411.68	5 381.75
(i)	as a percent of (ii)	8.42	10.47	8.31	7.53	7.60	7.26	7.04	5.33	9.49	8.72	7.83	8.43	7.37	5.91	6.72	5.08

Source: IMF "Direction of Trade" (DOT).

1/ A few countries were not included because data on them were not available at the time of preparing the table.

2/ Where Imports of one country as published in DOT were consistently and significantly lower than corresponding exports of the other country, the latter figures were as much as possible used to derive imports of the former. For countries whose data are not yet reported in DOT, their figures were derived from those of trading partners, following the method used in DOT.

TABLE 1b. MERCHANDISE TRADE OF EACH OF THE EASTERN AND SOUTHERN AFRICAN COUNTRIES WITH THE WORLD[1/]
(Million of US$)

	EXPORTS (f.o.b)								IMPORTS (c.i.f)							
	1970	1971	1972	1973	1974	1975	1976	1977	1970	1971	1972	1973	1974	1975	1976	1977
Botswana	..	..	..	..	..	120.75	175.95	..	51.75	69.00	111.55	119.60	147.20	182.85	208.15	..
Burundi	24.30	18.50	26.00	29.80	29.51	31.92	57.24	78.15	22.30	29.90	31.30	31.20	43.12	61.66	58.29	74.10
Ethiopia	122.73	125.62	166.79	240.12	295.07	236.15	322.63	290.49	171.64	187.81	189.31	218.39	286.48	327.38	409.66	502.88
Kenya	304.90	314.30	359.20	474.30	602.90	601.80	793.10	1 186.00	442.40	560.40	535.00	616.40	1 026.30	928.60	972.90	1 289.10
Madagascar	144.83	146.91	164.09	202.70	244.07	300.19	291.83	382.99	170.40	213.34	202.35	203.27	281.06	241.36	213.83	272.78
Malawi	59.15	72.08	81.25	99.35	119.20	136.83	160.18	204.69	94.21	109.04	129.67	143.15	187.88	250.01	205.73	234.85
Mauritius	71.40	68.03	106.15	133.00	312.40	298.13	212.84	312.13	72.74	83.03	120.18	171.19	308.96	331.53	335.58	439.20
Rwanda	24.70	22.30	19.30	33.08	37.15	42.18	81.09	90.34	28.90	32.70	34.30	34.00	58.59	95.89	105.03	113.90
Somalia	31.34	34.50	43.42	48,24	62.05	87.45	114.59	94.11	45.10	62.66	77.56	109.48	129.40	196.52	164.72	299.49
Swaziland	70.51	76.99	80.40	105.17	176.10	196.32	191.32	180.59	59.85	66.87	69.40	96.21	137.57	179.79	200.20	231.62
Tanzania	260.57	278.39	318.74	340.84	420.20	387.77	492.08	544.93	318.38	381.66	410.66	488.49	812.83	842.52	656.07	774.67
Uganda	279.20	260.19	283.82	310.38	327.01	278.13	360.55	560.63	171.92	249.62	162.16	162.54	213.05	196.64	160.28	378.12
Zambia	1 001.00	679.30	758.50	1 116.40	1 406.60	811.50	910.80	953.80	481.77	554.59	571.05	536.21	795.27	937.99	221.24	821.04
Total	2 394.63	2 097.11	2 407.66	3 153.38	4 032.27	3 529.13	4 164.20	4 878.85	2 131.36	2 610.62	2 644.49	2 930.14	4 427.71	4 782.74	4 411.68	5 381.75

Source: IMF, "Direction of Trade" (DOT).

1/ Few countries were not included because data on them were not available at the time of preparing the table.

TABLE 2: MAJOR EXPORTS OF EASTERN AND SOUTHERN AFRICAN (ESA) COUNTRIES[1/]

	Frequency of each export by country	Malagasy	Lesotho	Malawi	Rwanda	Tanzania	Uganda	Ethiopia	Kenya	Somalia	Swaziland	Burundi	Zambia	Mauritius
Coffee	7	Coffee			Coffee	Coffee	Coffee	Coffee	Coffee			Coffee		
Tea	4			Tea	Tea		Tea		Tea					
Sugar	4	Sugar		Sugar							Sugar			Sugar
Cotton	4			Cotton		Cotton	Cotton					Cotton		
Live animals	3		Live animals (excluding cattle)					Live animals		Live animals				
Copper	2						Copper						Copper	
Hides and skins	2							Hides and skins		Hides and skins				
Diamonds	2		Diamonds			Diamonds								
Groundnuts	1			Ground-nuts										
Zinc	1												Zinc	
Tobacco	1			Tobacco										
Sisal	1					Sisal								
Petroleum	1								Petroleum					
Oil products	1	Oil products												
Vanilla	1	Vanilla												
Cloves	1	Cloves												
Rice	1	Rice												
Bananas	1									Bananas				
Tin	1				Tin									
Wolfram	1				Wolfram									
Timber	1										Timber			
Iron ore	1										Iron ore			
Wool	1		Wool											
Mohair	1		Mohair											
Cattle	1		Cattle											
Foodstuffs	1		Foodstuffs											
Number of major exports of each country		4	6	5	4	4	4	3	3	3	3	2	2	1

1/ Four countries are not included because information on them was not available at the time of compiling the table.

Source: UNP.

Table 3: Exchange rate arrangements of Eastern and Southern African (ESA) countries

29 December 1978[a/]

Country	Name of currency	Exchange rate maintained against	Exchange rate b/
Kenya	Shilling	SDR	9.66
Mauritius	Rupee	SDR	7.713759
Malawi	Kwacha	SDR	1.05407
Tanzania	Shilling	SDR	9.66
Uganda	Shilling	SDR	9.66
Zambia	Kwacha	SDR	0.976311
Botswana	Pula	US$	0.828157
Burundi	Franc	US$	90.00
Ethiopia	Birr	US$	2.07
Rwanda	Franc	US$	92.04
Somalia	Shilling	US$	6.2327
Lesotho	Rand	South African Rand	1.00
Swaziland	Rand	South African Rand	1.00
Madagascar	Franc	French Franc	50.00

Source: "IMF Survey", 22 January 1979.

a/ A few countries are not included because information on them was not available at the time of compiling the table.

b/ Rates are as notified to the IMF and are in terms of currency units per unit to which a currency is linked.